#### **AGENDA**

#### **Finance Commission of Texas**

# AUDIT COMMITTEE MEETING

Friday, June 15, 2012 8:45 a.m.

Hearing Room E2.028, Texas Capitol Extension Austin, Texas 78701

Public comment on any agenda item or issue under the jurisdiction of the Finance Commission agencies is allowed unless the comment is in reference to a rule proposal for which the public comment period has ended. However, upon majority vote of the Commission, public comment may be allowed related to final rule adoption.

- A. Review and Approval of Minutes of the April 20, 2012, Audit Committee Meeting.
- B. Audit Committee Review of Agencies' Activities.
- C. Discussion of and Possible Vote to Recommend that the Finance Commission Take Action on the Office of the Consumer Credit Commissioner's Investment Policy.

NOTE: The Audit Committee may go into executive session (close its meeting to the public) on any agenda item if appropriate and authorized by the Open Meetings Act, Texas Government Code, Chapter 551.

Meeting Accessibility: Under the Americans with Disabilities Act, the Finance Commission will accommodate special needs. Those requesting auxiliary aids or services should notify Tammy King Wooten, Department of Savings and Mortgage Lending, 2601 North Lamar Boulevard, Austin, Texas 78705, (512) 936-6222, as far in advance of the meeting as possible.

#### MINUTES OF THE

# **Finance Commission Audit Committee Meeting**

Friday, April 20, 2012

The Audit Committee of the Finance Commission of Texas met Friday, April 20, 2012, in Hearing Room E2.028, Texas Capitol Extension, 1100 N. Congress Avenue, Austin, Texas.

#### Members in attendance:

Cindy Lyons, Audit Committee Chair Lori McCool, Audit Committee Member Bill White, Audit Committee Member and Chair, Finance Commission

#### Others in attendance:

Susan Burton, Finance Commission Member

Darby Byrd, Finance Commission Member

Stacy London, Finance Commission Member

Jonathan Newton, Finance Commission Member

Larry Patton, Finance Commission Member

Paul Plunket, Finance Commission Member

Jay Shands, Finance Commission Member

Doug Foster, Executive Director to the Finance Commission and Commissioner, Texas Department of Savings and Mortgage Lending (SML)

Leslie Pettijohn, Commissioner, Office of Consumer Credit Commissioner (OCCC)

Christina Cuellar, Accounting Manager, Office of Consumer Credit Commissioner (OCCC)

Stephanie Newberg, Deputy Commissioner, Texas Department of Banking (DOB)

Kurt Purdom, Director of Bank and Trust Supervision, Texas Department of Banking (DOB)

Bob Bacon, Deputy Commissioner, Texas Department of Banking (DOB)

Antonia Antov, Director of Administration and Finance, Texas Department of Savings and Mortgage Lending (SML)

Jim Crowson, Assistant Attorney General, Office of the Attorney General

Audit Committee Chair Cindy Lyons announced a quorum was present, with all Committee Members (Mr. White and Ms. McCool) present. She called the meeting to order at 9:05 a.m.

A. Review and Approval of Minutes of the February 16, 2012, Audit Committee Meeting.

Lori McCool made a motion to approve the minutes of the February 16, 2012, Audit Committee meeting. Bill White seconded and the minutes were adopted.

B. Audit Committee Review of Agencies' Activities.

Office of Consumer Credit Commissioner

Commissioner Pettijohn gave an overview of the Outstanding Audit Findings Report as of March 31, 2012. She highlighted areas relating to a business licensing internal audit by Garza/Gonzales & Associates.

Texas Department of Banking

Deputy Commissioner Newberg reported that the agency received a letter from the Texas Workforce Commission stating that on May 22, 2012, an audit will be conducted on the Department's personnel policies and procedures. She indicated that the audit finding may be available for the August Finance Commission meeting.

Director Kurt Purdom, provided an overview of the June 2009, outstanding audit findings of the banking examination audit from the State Auditor's Office. He also highlighted the timeliness of the examination report process.

Texas Department of Savings and Mortgage Lending

Commissioner Foster reported that there were no outstanding audit issues for SML.

C. Discussion of and Possible Vote to Recommend that the Finance Commission Take Action on the Agencies' February 29, 2012, Investment Officer Reports.

Office of Consumer Credit Commissioner

Christina Cuellar, Accounting Manager, provided an overview of the investment officer report highlighting the new Financial Education Endowment Fund.

Commissioner Pettijohn presented a handout of the Texas Treasury Safekeeping Trust Company Investment Policy Statement for Texas Endowment Funds. She highlighted the fund objectives, expectations, asset management and investment strategy.

The Commissioner noted a statutory requirement that the funds be placed with the Texas Treasury Safekeeping Trust Company.

There was discussion among Commission Members in reference to the Endowment Fund guidelines and the goals for the fund. Chairman White commented that one of the Committees may be assigned to work with Commissioner Pettijohn regarding the development of the policies and procedures relating to the operations of the fund.

Texas Department of Banking

Deputy Commissioner Newberg gave an overview of the Insurance Funded Prepaid Funeral Guaranty Fund Quarterly Investment Report and the Trust Funded Prepaid Funeral Guaranty Fund Quarterly Investment Report. She also updated members on seized prepaid funeral funds.

Texas Department of Savings and Mortgage Lending

Director Antonia Antov presented an overview of the Investment Officer Report detailing the agency's Recovery Fund investment and operating activities. Commissioner London commented on the significant amount of potential payment of claims and asked for clarification on the amounts. It was explained that the potential payment of claims represents the amounts that maybe paid out of the recovery fund if merit is found in the claim requests.

Lori McCool made a motion to recommend that the Finance Commission accept the Agencies' February 29, 2012, Investment Officer Reports. Bill White seconded and the motion was adopted.

D. Discussion of and Possible Vote to Recommend that the Finance Commission Take Action on the Agencies' Second Quarter Financial Statements.

Office of Consumer Credit Commissioner

Christina Cuellar, Accounting Manager, presented an overview of the Second Quarter Operating Statement and Budget Analysis. She detailed the variances while explaining the agency's revenues and expenditures.

She discussed the regulated lender and motor vehicle revenues being above budget numbers due to the number of applications received within the first quarter.

Ms. Cuellar also gave an overview of the agency's expenditures noting that personnel costs were below budget due to vacant positions and the delay in hiring of full time employees. There was discussion regarding the total fund balance including application fees for CAB applications and Crafted Precious Metals registration.

The members requested clarification on the penalty revenue and Commissioner Pettijohn addressed their questions.

Texas Department of Banking

Deputy Commissioner Newberg gave an overview of the agency's Second Quarter Financial Statements, highlighting the Department's total revenues and budgeted expenditures. An update and progress report with projections was also provided for Frost Bank.

Texas Department of Savings and Mortgage Lending

Director Antonia Antov presented the Second Quarter Financial Statements for SML and gave an overview of the agency's Operating Statement and Budget Analysis. She highlighted the total revenues and expenditures detailing licensing fees, which are currently 22% above budget.

She detailed the agency's fines and penalty items that were due to the first cycle of mortgage banker examinations and the collection of penalties relating to unlicensed activities. There was discussion regarding personnel benefits and employee staffing.

Committee Chair Lyons requested detailing the budget variance points and cash position at the next meeting.

Lori McCool made a motion to recommend that the Finance Commission accept the Agencies' Second Quarter Financial Statements. Bill White seconded and the motion was adopted.

E. Discussion of and Possible Vote to Recommend that the Finance Commission Take Action on the Office of Consumer Credit Commissioner's Follow-up Audit Report as Prepared by the State Auditor's Office.

Commissioner Pettijohn gave an overview of the prior audit report from the State Auditor's Office. She detailed the implementation of the recommended audit items.

Bill White made a motion to recommend that the Finance Commission Accept the Office of Consumer Credit Commissioner's Follow-up Audit Report as Prepared by the State Auditor's Office. Lori McCool seconded and the motion was adopted.

F. Discussion of and Possible Vote to Recommend that the Finance Commission Take Action on the Audit of the Department of Banking's Prepaid Funeral Guaranty Funds.

Deputy Commissioner Newberg gave an overview of the agency's internal audit report prepared by Garza/Gonzalez & Associates. She highlighted the areas that were reviewed and the assessments of the Prepaid Funeral Guaranty Funds.

Lori McCool made a motion to recommend that the Finance Commission Accept the Audit of the Department of Banking's Prepaid Funeral Guaranty Funds. Bill White seconded and the motion was adopted.

Commissioner Foster highlighted several upcoming informational items involving the budgeting process for the fiscal year 2013. He discussed the conclusion of the Strategic Planning process would be in June allowing the agency budgets to be posted on the agencies websites on July 18-20, 2012. Thereafter, accepting any public comments.

Commissioner Foster noted a public hearing on the agencies budgets is scheduled for July 30, 2012, with additional written comments being accepted until August 3, 2012. The budgets will then be finalized, for submission to the members, the week of August 7, 2012.

He discussed the agreement with the members for an extension request with Garza/Gonzalez & Associates of their audit contracts.

There being no further business, Committee Chair Cindy Lyons adjourned the meeting of the Audit Committee of the Finance Commission on April 20, 2012, at 9:52 a.m.

Cindy Lyons, Chair of the Audit Committee	
Finance Commission of Texas	
Doug Foster, Executive Director of the	·········
Finance Commission of Texas	
Tammy King Wooten, Executive Assistant	
Finance Commission of Texas	

This page left blank intentionally.

# Texas Department of Savings and Mortgage Lending Outstanding Audit Issues Report as of 5/31/2012

No Outstanding Audit Issues

# Office of Consumer Credit Commissioner

# Outstanding Audit Findings Report as of 05/31/2012

Garza / Gonzale	z & Associates	Audit Report Date
Business Licens	ing	Aug-11
	Status Update	
	sales finance and property tax lenders are	to exceed". These amendments will be so of each regulated area. The motor vehicle scheduled for rule review in 2012. The scheduled until 2014 for rule review; however,
Garza / Gonzale	z & Associates	Audit Report Date
Business Licens	ing	Aug-11
	Status Update	
e application " to the AC and revise, as ecessary, to eeded license equirements are form.	Fully Implemented.	
	Garza / Gonzale Business Licens  application to the C and revise, as ecessary, to eeded license equirements are	In Progress. The agency, for better clarificating to fees to include the wording "not done during the regular rule review proces sales finance and property tax lenders are pawnshops and regulated lenders are not where feasible the agency will amend these Garza / Gonzalez & Associates  Business Licensing  Status Update  application to the Cand revise, as ecessary, to eeded license equirements are

# Texas Department of Banking Outstanding Audit Findings Report as of May 2012

Auditor	State A	uditor	Audit Report Date
Audit Area	Bank Ex	aminations	June 2009
Finding	-	Status Update	
Improve timeline examination reports processing		Substantially Implemented – For the fiscal year quarters of fiscal year 2012, 46% and 69%, responding mailed within policy guidelines. Ho conducted with the federal regulators are exclipolicy guidelines in the three quarters of fiscal average number of days late for all commercial quarters of fiscal year 2012, which is an improfor fiscal year 2011.	pectively, of the examination reports wever, when joint examinations uded, the percentage mailed within all year 2012 increases to 79%. The all examinations was 13 in the three
Conduct bank examinations in a manner	a timely	Substantially Implemented – As noted in the Soperating with 32 fewer commissioned examin required, which made correction of this audit audit, the Department has slightly reduced the compared to the staffing plan, which results in fiscal year ending August 2011 and the three q 48%, respectively, of the examinations were The average days late to begin an examination 2012 were 31 days, compared to 37 days for fis	ners than the agency's staffing plan finding challenging. Since the SAO deficit of commissioned examiners more timely examinations. For the uarters of fiscal year 2012, 53% and conducted within policy guidelines. In in the three quarters of fiscal year
Contact banks within the first half of the examination cycle		Substantially Implemented – The Banker Call Program is not designed to identify risk, but to encourage a free exchange of information between the Department and bankers outside the normal examination process. For the three quarters of fiscal year 2012, all contacts were made, but some fell outside of the agency's policy guidance. In all, 93% of the required banker contacts were made within the timeframe of the policy guidelines.	
Auditor	Texas V	Vorkforce Commission	Audit Report Date
Audit Area	Compli	ance with Texas Labor Code Chapter 21	Field work completed in May; have not received report

This page left blank intentionally.

# OFFICE OF CONSUMEREDIT COMMISSIONER INVESTMENT POLICY STATEMENT

#### 1. Overview

This policy governs the investment of funds maintained by the Office of Consumer Credit Commissioner ("Agency"). This policy does not convey investment authority where such does not exist through statute. This policy shall be approved by the Finance Commission of Texas (Finance Commission) as this policy applies to funds within its purview. The policy will be reviewed biannually by the Finance Commission, with said review and any changes made to either the policy or investment strategies recorded in the minutes of the Finance Commission.

The Finance Commission met on \_\_\_\_\_\_, 2012 to approve changes to this policy. On February 17, 2012, the Finance Commission re-approved this policy which was revised as a result of House Bill 2226 enacted by the 82<sup>nd</sup> Legislature. Previous changes to this policy were approved on October 15, 2010.

It is the policy of the Agency to invest funds in compliance with the following priorities, in the order of importance:

- Preservation of principal;
- · Maintenance of liquidity as appropriate to the identified need; and,
- Procurement of an appropriate yield.

All investments shall be made with the judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived.

To the extent that diversification of investment types and maturities assists in the achievement of the above-named priorities, investment strategies for the different funds held will consider the appropriate mix of investments.

#### 2. Identification of Covered Funds

Funds covered by this policy are funds authorized to be collected by the Texas Finance Code.

OCCC Operating F	und (TTSTC #2973)
Enabling Legislation	§16.003, Tex. Fin. Code

OCCC Resident	ial Mortgage Loan Originator Recovery Fund (TTSTC #3008)
Enabling Legislation	Sections 341.601 et seq., Tex. FIN. CODE
Distribution Policy	The fund shall be used to reimburse residential mortgage loan applicants for actual damages incurred because of acts committed by a state-licensed residential mortgage loan originator who was licensed under the applicable chapter when the act was committed. Recovery is limited by the provisions of §341.206 to an aggregate of \$25,000 per claim.

Texas Financial Education Endowment Fund (TTSTC #3071)		
Enabling Legislation	§393.628, Tex. Fin. Code	
Distribution Policy	Annual distributions, payable quarterly or annually, are calculated as 4.5% times the twenty-quarter, moving-average value of the Fund as of June 30 for distributions to be made the following fiscal year.	

#### 3. Types of Authorized Investments

The Texas Financial Education Endowment Fund is to be invested with the Texas Treasury Safekeeping Trust Company (TTSTC). The Investment Policy Statement for Texas Endowment Funds of the Texas Treasury Safekeeping Trust Company is adopted by reference for the oversight of the Texas Financial Education Endowment Fund. These policies include:

- An investment return objective of 8%
- A securities lending objective to enhance current income to the extent consistent with the preservation of capital and maintenance of liquidity
- Portfolio rebalancing
- Portfolio hedging and overlays
- · Asset allocation targets and performance benchmarks
- Risk management guidelines
- Investment manager expectations
- Fixed income, equity, real estate and all asset strategies

The investment policies of the Texas Treasury Safekeeping Trust Company control over any conflict between this policy and the TTSTC investment policy for the Texas Financial Education Endowment Fund.

Other funds anticipated to be held for less than one year may be placed in the Texas Treasury Safekeeping Trust Company (or its successor), or in money market funds. However, other investment securities listed below may be utilized by the Agency. "Maximum allowable maturity," when used in this policy, means the remaining time until the final principal payment on the investment, measured from the date of purchase by the Agency.

- Obligations of the United States or its agencies and instrumentalities with a maximum allowable maturity of ten years;
- Direct obligations of this state or its agencies and instrumentalities with a maximum allowable maturity of ten years;
- Collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States with a maximum allowable maturity of ten years;
- Other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, this state or the United States or their respective agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation (FDIC) or by the explicit full faith and credit of the United States with a maximum allowable maturity of 10 years;

- Obligations of states, agencies, counties, cities, and other political subdivisions of any state
  rated as to investment quality by a nationally recognized investment rating firm not less than A
  or its equivalent with a maximum allowable maturity of ten years. If the rating of the issuing
  entity is downgraded below investment quality during the time an investment is held from that
  entity, all prudent measures must be taken to liquidate the investment within a reasonable
  period of time, consistent with the guidelines in this policy;
- Deposit accounts, including time accounts and certificates of deposit, in a depository institution that has its main office or a branch office in this state which:
  - o Are fully insured by the FDIC, or its successor; or,
  - Are 100% secured by securities allowable under this section for direct investment by the Agency, and
  - o Do not have a maturity exceeding 36 months.
- Bids for certificates of deposit may be solicited:
  - Orally;
  - o In writing;
  - o Electronically; or
  - o In any combination of those methods.
- Repurchase agreements, collateralized on a daily basis at a minimum of 102% of market value, including both direct security repurchase agreements and reverse security repurchase agreements, that:
  - o Do not have a defined termination date exceeding ninety days;
  - Are secured by a combination of cash and securities allowable under this section for direct investment by the Agency;
  - Require securities being purchased or cash held by the Agency to be pledged to the Agency, held in the Agency's name and deposited at the time the investment is made with the Agency or with a third party selected and approved by the Agency;
  - Are placed through a primary government securities dealer, as defined by the Federal Reserve, or an insured financial institution domiciled in this state; and
  - Requires that money received under the terms of a reverse security repurchase agreement shall be used to acquire additional authorized investments, but the term of the authorized investments required must mature not later than the expiration date stated in the reverse repurchase agreement.
- Mutual funds, if they are no-load money market mutual funds that:
  - o Are registered with and regulated by the Securities and Exchange Commission;
  - Provide the Agency with a prospectus and other information required by the Securities Exchange Act of 1934 or the Investment Company Act of 1940
  - o Have a dollar-weighted average stated maturity of 90 days or less; and,
  - o Include in their investment objectives the maintenance of a stable net asset value of \$1 for each share.
- Mutual funds, if they are no-load mutual funds that:
  - o Are registered with the Securities and Exchange Commission;
  - Have an average weighted maturity of less than two years;
  - o Are invested exclusively in obligations authorized in this policy; and,
  - Are continuously rated as to investment quality by at least one nationally recognized investment rating firm of not less than AAA or its equivalent.

#### 4. Unauthorized Investments

The following are not authorized investments under this policy:

- Obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal;
- Obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;
- Collateralized mortgage obligations that have a stated final maturity date of greater than 10 vears;
- Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index; and
- No portion of bond proceeds, reserves and funds held for debt service shall be invested in mutual funds.

#### 5. Safekeeping of Investments

All funds, securities, etc., held under this policy, where possible, will be placed under the name of the Office of Consumer Credit Commissioner and safekeeping receipts will be maintained on file.

#### 6. Reporting

Not less than quarterly, the Investment Officer shall prepare and submit to the Finance Commission and Finance Commission Chairman a signed, written report of investment transactions for all funds covered by this policy for the preceding reporting period, to include:

- The investment position of the Agency on the date of the report;
- The book and market values of each separately invested asset at the beginning and end of the reporting period by the type of asset and fund type invested (for demand deposits and certificates of deposit, reports will reflect book value and market value as the same);
- The maturity date of each separately invested asset that has a maturity date;
- The fund for which each individual investment was acquired;
- Any non-compliance of the investment portfolio with this policy;
- Income received and expenses incurred in conjunction with investments; and,
- Any other information as required by the Finance Commission.

#### 7. Rates of Return and Market Pricing

The Agency expects to receive market rates of return on all investments authorized under this policy, remembering the need to first, protect principal and second, maintain sufficient liquidity to meet the needs of the specific funds being invested. Higher rates of return will be targeted on the more aggressive and longer term investment products. No rate of return is expected to be earned on any funds in a checking account, and therefore these will be kept to a minimum.

The Investment Officer will periodically review the market pricing and rates of return on all investments to ensure that values and yields are consistent with risk and meet investment objectives.

#### 8. Diversification

Investments in FDIC-insured deposits (or in deposits not insured by the FDIC but otherwise secured by state or federal government obligations with margin) and in direct U.S. Treasury obligations are not subject to diversification other than maturity considerations. For investments other than those just listed, diversification shall be as follows:

• Specific mutual funds, if they are no-load mutual funds, are eligible for investment up to a limit of no more than 15 % of a covered fund's average balance;

- No one covered fund shall invest in mutual funds in the aggregate more than 80% of its monthly average balance; and,
- No covered funds shall be invested in any one mutual fund in an amount that exceeds 10% of the total assets of the mutual fund.

#### 9. Settlement

Settlement of all transactions, except investment pool funds and mutual funds, shall be on a delivery versus payment basis.

#### 10. Investment Officer

The Accounting Manager will be the designated Investment Officer for the funds held and invested by the Agency. The Investment Officer is authorized to:

- Obtain external investment expertise if deemed necessary to fulfill investment objectives;
- Delegate routine business transactions within authorized and established investments; and,
- Enter into agreements with other parties as necessary to fulfill this policy, make or authorize investments, or notify other parties concerning this policy and its requirements.

If the Investment Officer has a personal business relationship with a business organization offering to engage in an investment transaction with the Agency, the Officer shall file a statement disclosing that personal business interest. For the purposes of this policy, an investment officer has a personal business relationship with a business organization if:

- The investment officer owns 10% or more of the voting stock or shares of the business organization or owns \$5,000 or more of the fair market value of the business organization;
- Funds received by the investment officer from the business organization exceed 10% of the investment officer's gross income for the previous year; or
- The investment officer has acquired from the business organization during the previous year investments with a book value of \$2,500 or more for the personal account of the investment officer.

If the Investment Officer is related within the second degree by affinity or consanguinity to an individual seeking to sell an investment to the Agency, the Officer shall file a statement disclosing that relationship. Any statement filed under this paragraph shall be filed with the Texas Ethics Commission and the Finance Commission.

#### 11. Investment Training

The Investment Officer and other agency employees active in the investment function will attend training relating to their respective responsibilities under this policy, not less than once each state fiscal biennium Training may include education in investment controls, security risks, strategy risks, and market risks.

Any training conducted or approved by any state or federal agency, independent of the Agency, related to investments, risk management, portfolio diversification, or similar substance, is hereby approved by the Finance Commission as meeting the terms of this requirement.

The Investment Officer shall provide a report to the Finance Commission regarding the status of investment training at the time of the biannual review of the policy.

#### 12. Entities Authorized to Engage in Investment Transactions

Investments may be obtained through licensed securities brokers, commercial banks, state savings banks, and trust companies authorized to do business in Texas. To the extent that deposits and accounts are insured or secured for the full amount of principal and interest, no specific authorization from the

Finance Commission is required as long as the individual institution falls under the requirements of this policy. All brokerage activities will be transacted using qualified brokerage firms. Qualified brokerage firms must be regulated by the Securities Exchange Commission and be members of Financial Industry Regulatory Authority (FINRA).

#### 13. Acknowledgment of the Policy by Persons Seeking to Sell Investments to the Agency

A written copy of this policy must be presented to any person offering to engage in an investment transaction with the Agency. A qualified representative of the business organization offering to engage in an investment transaction with the Agency shall execute a written acknowledgment (Appendix #1) that the business organization:

- Has received and reviewed the Investment Policy for Funds under the Oversight of the Finance Commission of Texas; and,
- Acknowledges that the business organization has implemented reasonable procedures and
  controls in an effort to preclude investment transactions conducted between the Agency and
  the organization that are not authorized by the Agency's investment policy, except to the extent
  that this authorization is dependent on an analysis of the makeup of the Agency's entire
  portfolio or requires an interpretation of subjective investment standards.

The Investment Officer may not acquire or otherwise obtain any authorized investment described in the investment policy, or renew depository or other agreements, from a person who has not delivered to the Agency the instrument in substantially the form provided.

#### Acknowledgment

- I, (<u>broker/banker/trust company officer</u>), a qualified representative of (<u>name of brokerage</u> facility/bank/trust company), hereby make the following statements:
- I have received and reviewed the Investment Policy for Funds under the Oversight of the Finance Commission of Texas; and,
- I acknowledge that <u>(name of brokerage facility/bank)</u> has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the Office of Consumer Credit Commissioner and <u>(name of the brokerage facility/bank/trust company)</u> that are not authorized by the referenced Investment Policy, except to the extent that this authorization is dependent on an analysis of the makeup of the Office of Consumer Credit Commissioner's entire portfolio or requires an interpretation of subjective investment standards.

Signature of Qualified Representative	Date



# INVESTMENT POLICY STATEMENT TEXAS ENDOWMENT FUNDS

# TABLE OF CONTENTS

CHAPTER	PAG
I. General Information	3
II. Funds Subject to this Policy	4
III. Fund Enabling Legislation & Distribution Policies	· ·
IV. Fund Objectives & Expectations	
V. Asset Allocation & Performance Benchmarks	8
VI. RISK MANAGEMENT & GUIDELINES	9
VII. Investment Managers	11
VIII. Fixed Income Strategies	
SECTION 2 SUB-STRATEGY DESCRIPTIONS	
A. SHORT-TERM INVESTMENT FUNDS.	
B. GLOBAL FIXED INCOME	
C. ALTERNATIVE FIXED INCOME	-
d. Private Debt	13
IX. EQUITY STRATEGIES	14
SECTION 2 SUB-STRATEGY DESCRIPTIONS	
a. Global Equity	14
B. HEDGED EQUITY	14
C. PRIVATE EQUITY	15
X. Real Assets Strategies	16
SECTION 2 SUB-STRATEGY DESCRIPTIONS	
A. STABLE VALUE REAL ESTATE	16
B. ENHANCED RETURN REAL ESTATE	17
C. GLOBAL INFLATION PROTECTED SECURITIES	17
d. Natural Resources	17
XI. ALL ASSET STRATEGIES	18
SECTION 2 SUB-STRATEGY DESCRIPTIONS	•
A. RISK PARITY	18
B. TACTICAL ASSET ALLOCATION	18
C. Multi-Strategy Hedge	18
Addenity $\Delta = \Delta \cos T C$ are Renchmarks	19

#### CHAPTER I. GENERAL INFORMATION

#### SECTION 1.

#### COMPTROLLER OF PUBLIC ACCOUNTS & TEXAS TREASURY SAFEKEEPING TRUST COMPANY

The Texas Comptroller of Public Accounts (the "Comptroller") invests the hereinafter-described funds with the advice of and in consultation with the Comptroller's Investment Advisory Board (the "IAB") and the Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the "Tobacco Committee") with respect to the Tobacco Settlement Permanent Trust Account. The Comptroller administers the funds through the Texas Treasury Safekeeping Trust Company (the "Trust Company"). The Trust Company is a corporation created by the Comptroller pursuant to state law to enable the Comptroller to manage funds more efficiently and economically. The Comptroller is the sole officer, director, and shareholder of the Trust Company and charged with managing the company. The Comptroller has delegated management and investment related duties to the chief executive officer of the Trust Company.

#### SECTION 2.

#### **COMMITTEES**

#### A. INVESTMENT COMMITTEE

The Trust Company Investment Committee ("Investment Committee") is responsible for oversight of Trust Company investment portfolios including: reviewing and recommending investment policies; approving certain investments; establishing strategic and tactical investment plans; evaluating and recommending the selection or dismissal of investment managers; reviewing quarterly portfolio performance; reviewing and approving portfolio rebalancing and tactical asset allocation.

Investment committee members include: Chief Investment Officer (Chair); Deputy Chief Investment Officer (Vice-Chair); Director Internal Investments; Chief Financial Officer; General Counsel; General Investment Consultant; Compliance Officer (non-voting, Secretary).

The Investment Committee shall review this Investment Policy Statement ("Policy") at least annually and recommend necessary changes, if any, to the IAB, the Tobacco Committee, and the Comptroller.

#### B. ASSET VALUATION COMMITTEE

The Trust Company Asset Valuation Committee is responsible for establishing and monitoring the accounting and financial process for determining the fair value measurements and disclosures included in the Trust Company's financial statements.

The Committee is also responsible for reviewing the valuation methods including significant valuation assumptions, the computed asset valuation, and the presentation and disclosure of the fair value measurements and disclosures used in the financial statements. The Chief Financial Officer will serve as chair for the Committee.

## CHAPTER II. FUNDS SUBJECT TO THIS POLICY

# LOBACCO SEFFEMENT PROCEED FUNDS

These trusts are established for education and health services and facility purposes and funded with appropriations from the original \$15 billion settlement of the state's suit against the tobacco companies and the additional amount received under the "most favored nation" provision of the settlement agreement. They are: (A) The Tobacco Settlement Permanent Trust Account, which the Comptroller must invest in accordance with the prudent person standard. (B) The Permanent Fund for Tobacco Education and Enforcement; Permanent Fund for Children and Public Health; Permanent Fund for Emergency Medical Services and Trauma Care; Permanent Fund for Rural Health Facility Capital Improvement; and the Permanent Hospital Fund for Capital Improvement and the Texas Center for Infectious Disease. The Comptroller must invest these funds in accordance with the prudent investor standard. (C) The Permanent Health Fund for Higher Education-University of North Texas Health Center, which the Comptroller must also invest in accordance with the prudent investor standard. (D) The Permanent Fund for Higher Education Nursing, Allied Health, and Other Health-Related Programs; and Permanent Fund for Minority Health Research and Education, which the Comptroller must invest in a manner that preserves the funds' purchasing power and distributions.

# PERMANENT ENDOWMENT FUND FOR RERAE COMMUNITEES HEAFTH CARE ENVESTMENT PROGRAM

This trust fund is established to provide assistance to health care professionals who locate in rural areas of the state. The Comptroller must invest the fund in accordance with the prudent investor standard.

# NATIONAL RESEARCH UNIVERSITY FUND

This constitutionally authorized trust fund is established to provide a dedicated, independent and equitable source of funding to enable emerging research universities in this State to achieve national prominence as major research universities. The Comptroller must invest this fund in accordance with the prudent investor standard.

# Texas Preservation Trust Lund

This trust account is to provide financial assistance to public or private entities for the acquisition, survey, restoration, or preservation of historic property located in Texas. The Comptroller must invest this fund in accordance with the prudent investor standard. Effective November 1, 2011, assets in this fund are to be converted to cash for deposit in the State Treasury in such a manner that minimizes the revenue loss to the State as required by §22.03 of SB 1, 82<sup>nd</sup> Legislature, 1<sup>st</sup> called session.

The above-described funds are hereinafter referred to as the "Funds" or the "Fund" as the context requires.

# CHAPTER III. FUND ENABLING LEGISLATION & DISTRIBUTION POLICIES

NATIONAL RE	SEARCH/UNIVERSITY TUND
Enabling	Article VII, section 20 of the Texas Constitution; Section 62.141149 of the Texas
Legislation	Education Code
Distribution Policy	No funds may be distributed before September, 2011. Annual distributions, payable quarterly or annually, are calculated as 4.5% times the twenty-quarter, moving-average value of the Fund as of June 30 for distributions to be made the following fiscal year. See Texas Constitution, Art. 7 §20 (f) (distribution restrictions).

TOBACCO SE	ITTLEMENT PERMANENT TRUSE ACCOUNT
Enabling	Sections 403.1041 (Fund), 403.1042 (Tobacco Committee) of the Texas Government
Legislation	Code
Distribution Policy	Annual distributions are calculated in accordance with a formula established by rule: 5% of the 20 quarter moving average value of the Fund distributed as follows: 4.5% to political subdivisions; 0.5% to the Distribution Stabilization Account ("DSA"). The DSA is used to supplement distributions in years when net earnings are less than the calculated distribution amount. See 34 Tex. Admin. Code § 18.2 (2006) (rule setting out calculation formula and further restrictions).

Permanent la	nd for Tobacco Education and Enforcement; nd for Emergency Medical Services and Trauma Care; nd for Children and Public Health;
Permanent Im	nd for Rural Health Facility Capital Improvement; and spital Fund for Capital Improvements and the Texas Center for Infectious Disease
Enabling Legislation	Sections 403.105, 403.1055, 403.106, 403.1065, 403.1066, and 403.1068 of the Texas Government Code
Distribution Policy	Annual distributions, payable quarterly, are calculated as 4.5% times the twenty-quarter, moving-average value of the Fund as of June 30 for distributions to be made the following fiscal year. The annual distribution may not exceed 7% of the average net fair market value of the investment assets. See Tex. Gov't Code § 403.1068 (d), (e) (Vernon Supp. 2005) (distribution restrictions)

	alth Fund for Higher Education - University of North Texas Health Science Center: 🔠 😘
	alth Eund for Higher Education Nursing; Allied Health & Other Health-Related Programs;
	nd for Minority Health Research & Education; and downent Fund for the Rural Communities Health Care Investment Program
Enabling	Sections 63.101, 63.102; 63.201, 63.202; 63.301, 63.302 of the Texas Education Code;
Legislation	and Sections 487.558, 487.559 of the Texas Government Code
Distribution	Annual distributions, payable quarterly, are calculated as 4.5% times the twenty-quarter,
Policy	moving-average value of the Fund as of June 30 for distributions to be made the
2 0229	following fiscal year.

LEXAS PRESER	RVATION TRUST FUND		
Enabling	Enabling Section 442.015 of the Texas Government Code		
Legislation	Section 442.013 of the Texas Government Code		
Distribution	Distributions, payable quarterly, are calculated as 4.5% times the twenty-quarter,		
Policy	moving-average value of the Fund.		

#### CHAPTER IV. FUND OBJECTIVES & EXPECTATIONS

#### SECTION 1.

#### INVESTMENT OBJECTIVE

The Funds' investment objective is to earn an annual total return that:

- Provides a predictable, stable stream of distributions;
- Ensures that the inflation-adjusted value of distributions is maintained over the long-term; and
- Ensures that the inflation-adjusted value of the corpus, after distributions and fund expenses, is maintained over the long-term.
- Achieves the desired portfolio volatility and minimizes downside risk through diversification and risk management

The long-term annual rate of return objective is derived as follows:

Management Expenses	0.50%
Inflation Rate	3.00%
Distribution Rate	4.50%
Investment Return Objective	8.00%

#### SECTION 2.

#### SECURITIES LENDING

#### GENERAL OBJECTIVES:

The purpose of securities lending is to enhance current income to the extent consistent with the preservation of capital and maintenance of liquidity.

#### SECURITIES LENDING COLLATERALIZATION LEVELS:

Initial collateral levels will not be less than 102% of the market value of the loaned securities, or not less than 105% if the loaned securities and the collateral are denominated in different currencies. Marking to market is performed every business day, subject to de minimis rules of change in value. The securities borrower is required to deliver additional collateral when necessary so that the total collateral held by the agent will at least equal the market value of all the borrowed securities.

#### **INVESTMENT GUIDELINES:**

Due to the relative size of the pool of securities eligible for lending, the cash collateral resulting from securities lending activities shall be invested in a co-mingled fund managed by the securities lending agent in accordance with Chapter VIII, Section 2. A. of this policy, Short-Term Investment Funds.

#### PERFORMANCE AND RISK EXPECTATIONS:

Securities lending activities will be conducted through an agent selected by the Trust Company. The agent is required to provide indemnification for all losses to the Endowment Fund in the event of a borrower default. The agent shall retain the right to terminate a loan at any time.

#### SECTION 3.

#### PORTFOLIO REBALANCING

Allocations to the asset classes will be rebalanced to within the target allocation ranges, as necessary, based on the fair market value of the "portfolios," (i.e., the investment strategy or sub-strategy as the context requires.) Cash inflows and outflows will be used to help maintain allocations within the target allocation ranges and reduce turnover expenses. Following or preceding an anticipated cash flow, the asset allocation may temporarily fall outside the target allocation ranges.

Due to the relative illiquidity of the private market strategies, and the lag between capital commitments and contributions, rebalancing within these strategies can generally be achieved only through increasing or decreasing any new commitments. However, to the extent available, the Trust Company may use secondary markets for the purpose of asset allocation or rebalancing.

The Investment Committee approves significant portfolio rebalancing, when transitioning 5% or more of the Fund. When rebalancing less than 5% of the Fund, (to accommodate cash flows or interfund rebalancing) only two members of the Investment Committee are required to approve.

#### SECTION 4.

#### PORTFOLIO HEDGING AND OVERLAYS

The Trust Company may use a variety of available instruments to reduce or increase risk exposures to certain asset classes or risk factors. Portfolio hedging and overlays will be governed by the Portfolio Hedging and Overlays Policy.

3 - 24

#### CHAPTER V. ASSET ALLOCATION & PERFORMANCE BENCHMARKS

#### SECTION 1.

#### PERFORMANCE EXPECTATIONS

The investment performance of the Funds will be measured and compared to the stated benchmarks and a peer universe by an independent third party and reported quarterly to the Comptroller, Investment Committee and IAB. The performance benchmark for the Funds is a customized composite of the sub-strategy performance benchmarks weighted by target allocation percentages as set out below. Although specific benchmarks were used to determine the risk budget and asset allocation targets, the Trust Company intends to utilize strategies that invest in assets not included in the indices. A multi-factor risk and exposure analysis will be used to determine the appropriate sizing of each investment to achieve the desired diversification benefit, while remaining within the portfolio risk management limits set out in Chapter VI.

SECTION 2.

POLICY PORTFOLIO: ASSET ALLOCATION & BENCHMARKS

Strategy Sub-Strategy	Farget %	Benchmark(s)/Strategy Range
Fixed Income	35%	Allocation Range: 20%-50%
Global Fixed Income	10%	9% Barclays Capital Multiverse Bond Index; 1% 90-Day T-bill
Alternative Fixed Income	20%	HFRI FOF: Conservative Index
Private Debt	5%	Thomson Reuters Venture Economics Pooled Average – Custom weighted by vintage year
Equity	45%	Allocation Range: 30%-60%
Global Public Equity	15%	MSCI All Country World Index
Hedged Equity	20%	HFRI FOF: Strategic Index
Private Equity	10%	Thomson Reuters Venture Economics Pooled Average Custom weighted by vintage year
Real Assets	20%	Allocation Range: 10%-30%
Stable Value Real Estate	5%	NCREIF Townsend Core Index
Enhanced Real Estate	5%	Index market weighted blend of NCREIF Townsend Value Added & Opportunistic Indices
Global Inflation Protected Securities	3%	Barclays Capital World Inflation Linked Index
Natural Resources	7%	5% Dow Jones UBS Commodity Index; 1% MSCI Energy Index 1% MSCI Materials Index
All Asset Strategies	0%	0%-10%
Risk Parity, Tactical Asset Allocation, Multi-strategy	0%	Total Endowment Benchmark

See Appendix A to this Policy for descriptions of the benchmarks.

#### CHAPTER VI. RISK MANAGEMENT & GUIDELINES

#### SECTION 1.

#### RISK TOLERANCE

A certain amount of risk must be assumed in order to achieve the Funds' investment objective. The long-term nature of the Funds means that interim fluctuations in portfolio market values and rates of return can be tolerated in seeking to achieve the investment objective. Diversification is the primary tool for managing overall portfolio risk. Asset allocation guidelines and the investment manager structure will ensure adequate diversification to reduce the volatility of investment returns over the long-term. Annual liquidity needs are expected to be low and predictable. As such, and in consideration of the long-term or "perpetual" investment horizon of the Funds, opportunities to commit to longer-term, less liquid investments should be taken in order to capture illiquidity return premiums.

#### SECTION 2.

#### PERFORMANCE & RISK MONITORING

The Fund and each portfolio strategy and sub-strategy are expected to meet or exceed the total return performance objectives and risk-adjusted performance of the established benchmarks over a market cycle. Passive portfolios or index funds are expected to match the total return and risk profile of the relevant benchmarks. Active investment managers are expected to either exceed relevant benchmarks and/or reduce volatility. Although performance expectations are established for a market cycle, performance and risk analysis will be conducted on an on-going basis.

Risk limits will be established for the total Fund and each major Strategy. Fund and Strategy portfolio exposures and risk metrics will be regularly monitored. Although risk metrics will be measured and reviewed quarterly, evaluation will focus on a full market cycle.

The Fund will be reviewed quarterly, focusing on:

- Comparison of performance results to benchmarks:
- Comparison of risk metrics to expectations;
- Characteristics and multi-factor exposure analysis;
- Economic scenario and stress analysis;
- Analysis of liquidity for the Fund and each Strategy;
- Opportunities available in the relevant markets.

Value at Risk (VaR) Guidelines. Monthly portfolio VaR will be maintained between minimum and maximum VaR levels calculated on the basis of the maximum over and under-weights allowable for the three major Policy Portfolio asset strategy categories representing the minimum and maximum exposure to market risk for the total portfolio in accordance with the Value at Risk Tolerance Procedure.

#### SECTION 3.

#### **DIVERSIFICATION**

Excluding passive strategies, exposure to any investment firm will generally be limited to no more than 10% of Fund assets.

Fund investments will generally not exceed more than 25% of any firm's assets under management (AUM).

#### SECTION 4.

#### LIQUIDITY

The following guidelines are applied to the total portfolio. However, each Strategy shall contain sufficient liquidity in order to timely modify risk exposures, meet all liquidity needs, and conduct efficient rebalancing. Liquidity will be monitored at the sub-asset class level.

At least 20% of fund assets shall be invested in strategies that offer liquidity within 40 days.

At least 60% of fund assets shall be invested in strategies that offer liquidity within 185 days.

#### SECTION 5.

#### **DUE DILIGENCE**

Prior to investing Fund assets, proper due diligence will be conducted by Trust Company staff and/or its Consultants. Trust Company staff or its Consultants will meet with a representative of each external Investment Manager in person and on-site, as appropriate. Attending an investor conference where fund performance and portfolio positions are presented may serve as an on-site visit.

#### CHAPTER VII. INVESTMENT MANAGERS

#### SECTION 1.

#### EXPECTATIONS

The term "Investment Managers" includes any firm selected by the Trust Company that is responsible for investing Fund assets. Fund assets will be managed primarily by external investment firms and advisors, but may be managed directly by Trust Company investment staff. Both separate accounts and commingled vehicles (e.g., mutual funds, limited partnerships, common trust funds, exchange traded funds) may be used. Investment Managers are expected to act in an ethical manner and with integrity in all phases of the investment process.

Each Investment Manager has discretion to determine the appropriate mix of assets consistent with the strategy approved by the Trust Company. To generate competitive risk adjusted returns, investment managers may be authorized to use varied approaches – investing in not only both long and short positions, but also owning multiple asset classes (e.g., stocks, bonds, and currencies) and derivative instruments (e.g., futures, options, swaps).

Investment strategies will be combined to achieve the desired risk and return objectives of the Fund and each major Strategy. The Fund will be implemented using a mix of strategies that are:

- Highly correlated with the strategy benchmark and are invested primarily in assets consistent with the assets included in the strategy benchmark.
- Less correlated with the strategy benchmark and may be invested in assets that are not included in the strategy benchmark.

#### SECTION 2.

#### Internally Managed Transactions

Certain investment positions may be managed by Trust Company staff. All transactions are fully documented by the individual executing the trade, and confirmed by an independent member of the Investment Committee.

#### SECTION 3.

#### GENERAL INVESTMENT GUIDELINES

**TOBACCO RESTRICTION:** No funds shall be invested directly in the securities of any tobacco companies. This restriction shall apply only to separate accounts or when the Trust Company can dictate the terms.

**TAXATION:** Any income earned by the Trust Company is not considered gross income pursuant to 26 USC §115 United States Internal Revenue Code, therefore the Trust Company does not file federal income tax returns.

## CHAPTER VIII. FIXED INCOME STRATEGIES

#### SECTION 1.

#### STRATEGY DESCRIPTION

GENERAL OBJECTIVES: Fixed Income strategies are expected to generate relatively consistent positive returns with lower correlation to the public equity markets. Strategies selected are intended to provide positive returns during most economic and capital market environments.

Allocations will be made to strategies that are predominately fixed income securities, or derivatives of such, both long and short. Investment positions may be rate or credit spread sensitive and may be directional or hedged.

Investment strategies utilized will include exposures to investment grade that are more rate sensitive along with credit strategies that are more spread sensitive. Strategies will include exposures to both US and non-US sovereigns, corporate, structured notes, and asset-backed instruments.

**PERFORMANCE & RISK EXPECTATIONS:** The Trust Company intends to utilize a variety of investment strategies that in combination have similar risk characteristics and return expectations as the Barclays Global Universal Index. The following metrics, measured over a full market cycle, will be used when evaluating the composite Fixed Income portfolio.

- Beta & Correlation of at least 0.5 compared to the Barclays Capital Multiverse Bond Index.
- Meet or exceed the performance of the Barclays Capital Multiverse Bond Index
- Comparable to the volatility of the Barclays Capital Multiverse Bond Index

#### SECTION 2.

#### SUB-STRATEGY DESCRIPTIONS

#### A. SHORT-TERM INVESTMENT FUNDS

GENERAL OBJECTIVES: The purpose of this mandate is to preserve principal and provide liquidity to meet the cash flow requirements of the Fund. The Trust Company may invest in commingled short-term investment funds (Money market mutual funds managed consistent with 17 CFR §270. 2a-7 promulgated under the Investment Company Act of 1940 by the Securities and Exchange Commission ("Rule 2a-7")) or directly in liquid short-term securities (Securities that qualify, when purchased, for inclusion in funds managed consistent with Rule 2a-7).

**PERFORMANCE & RISK EXPECTATIONS:** This is a low risk strategy where liquidity is valued more than investment performance. Performance is expected to be comparable to a peer group of institutional money market funds and exceed the return of the 90-day US Treasury Bill.

- Funds will provide daily liquidity.
- Funds will be managed to maintain a stable Net Asset Value (NAV).

#### B. GLOBAL FIXED INCOME

GENERAL OBJECTIVES: The Global Fixed Income composite portfolio is intended to provide a consistent positive rate of return and to dampen the overall volatility of the Fund.

**PERFORMANCE & RISK EXPECTATIONS:** The composite portfolio's performance is expected to meet or exceed the established benchmark and be above median relative to a peer group of institutional quality funds.

- Beta & Correlation of at least 0.5 compared to the Barclays Capital Multiverse Bond Index.
- Meet or exceed the performance of the Barclays Capital Multiverse Bond Index
- Comparable to the volatility of the Barclays Capital Multiverse Bond Index
- The portfolio will be comprised of funds combined to provide diversification across issuer, geography, currency, sector, size of issuer, and credit quality.
- Individual strategies within this section will likely have a benchmark that is different than the composite's benchmark.

#### C. ALTERNATIVE FIXED INCOME

GENERAL OBJECTIVES: Alternative Fixed Income strategies are intended to preserve investment capital by achieving consistent positive real returns and maximizing long-term total returns, within prudent levels of risk, through the use of diversified portfolios of complementary strategies. The primary objective is to be a fixed income replacement and achieve a long-term total return competitive with the public fixed-income markets with low correlation to the equity markets.

**PERFORMANCE & RISK EXPECTATIONS:** While the particular vehicle's governing legal documentation will contain the specific guidelines for each offering, the following measures of performance, risk management and diversification will apply to the composite portfolio over a full market cycle:

- Total return is expected to meet or exceed the HFRI FOF: Conservative Index.
- Annualized volatility of returns comparable to the Barclays Capital Multiverse Bond Index.
- Correlation and beta less than 0.5 to the MSCI All Country World Index.
- The portfolio shall contain exposure to at least 5 individual funds.
- The portfolio will be diversified by manager, strategy, geography, & market capitalization.

#### D. PRIVATE DEBT

GENERAL OBJECTIVES: Private Debt strategies are intended to take advantage of illiquidity premiums available in the debt markets. Portfolios may contain illiquid debt or securities whose value may take an extended period to be realized.

**PERFORMANCE & RISK EXPECTATIONS:** The primary risks associated with this sub-strategy are credit and illiquidity. Other risks may include currency, interest rate or regulatory.

- Performance is expected to exceed that available in liquid debt markets.
- Investment performance above the median relative to peers, with particular emphasis on vintage year comparisons;
- The portfolio will be diversified by strategy, industry, market capitalization, geography and vintage year.

# CHAPTER IX. EQUITY STRATEGIES

#### SECTION 1.

#### STRATEGY DESCRIPTION

GENERAL OBJECTIVES: Equity strategies include public and private equities and asset classes that are correlated to global equity markets. Historically, global equity investments have provided returns in excess of the total Fund return objective. The Equity portfolio will consist of traditional long-only, hedged and private strategies whose portfolios are predominately invested in the equity of corporations.

**PERFORMANCE & RISK EXPECTATIONS:** The following metrics, measured over a full market cycle, will be used when evaluating the composite Market Return portfolio.

- Beta & Correlation of more than 0.5 to the MSCI All Country World Index.
- Meet or exceed the performance of the MSCI All Country World Index.
- Comparable volatility to the MSCI All Country World Index.

#### SECTION 2.

# SUB-STRATEGY DESCRIPTIONS

## A. GLOBAL EQUITY

GENERAL OBJECTIVES: The Global Equity composite portfolio is intended to achieve a total return in excess of the Fund's total return objective. The Trust Company will utilize a variety of Investment Managers, both long-only and long/short strategies, intended to fully represent the global investment opportunity set.

PERFORMANCE & RISK EXPECTATIONS: The following metrics of performance, risk management and diversification apply to the composite Global Equity portfolio:

- Performance is expected to exceed established benchmarks and be above median relative to a peer group of institutional quality funds.
- The composite portfolio's minimum composite portfolio beta. 0.75 to MSCI ACWI.
- The global equity portfolio will be diversified by country, industry, market capitalization and issuer.

# B. HEDGED EQUITY

GENERAL OBJECTIVES: Hedged Equity strategies are intended to preserve investment capital by achieving consistent positive real returns and maximizing long-term total returns, within prudent levels of risk, through the use of diversified portfolios of complementary strategies. The primary objective is to be an equity replacement and achieve a long-term total return competitive with the public equity markets with lower volatility of returns.

**PERFORMANCE & RISK EXPECTATIONS:** While the particular vehicle's governing legal documentation will contain the specific guidelines for each offering, the following measures of performance, risk management and diversification will apply to the composite portfolio over a full market cycle:

- Total return in excess of HFRI FoF Strategic Index.
- Annualized volatility of returns should be less than the MSCI ACWI.
- Correlation and beta should be greater than 0.5 to the MSCI ACWI.
- The portfolio shall contain exposure to at least 5 individual funds.
- The portfolio will be diversified by manager, strategy, geography, & market capitalization.

#### C. PRIVATE EQUITY

GENERAL OBJECTIVES: The Private Equity composite portfolio is intended to enhance overall portfolio returns relative to other major asset classes. It is a specialized investment offering the opportunity to earn competitive and higher risk-adjusted returns than those available in the traditional public equity markets. The portfolio consists of combined strategies that produce a portfolio of complementary focus areas, industries, financing stages, vintage years, and geographic representation designed to diversify the overall private equity portfolio. This portfolio may include domestic and international investments and may be denominated in USD and other major foreign currencies.

**PERFORMANCE & RISK EXPECTATIONS:** The composite portfolio is expected to meet the following objectives over a 10-year time period:

- Provide net of fee returns exceeding those available in the public equity markets;
- Investment performance above the median relative to peers, with particular emphasis on vintage year comparisons;
- Meet or exceed the performance of the Thomson Reuters Venture Economics Private Equity Index custom weighted by vintage year exposures of the fund. Exposures are defined as end-of-quarter adjusted valuations.
- The portfolio will be diversified by strategy, industry, market capitalization, geography and vintage year.

#### CHAPTER X. REAL ASSET STRATEGIES

#### SECTION 1.

#### STRATEGY DESCRIPTION

GENERAL OBJECTIVES: Real Asset strategies are intended to serve primarily as inflation hedges and provide diversification benefits of low correlation with other investment strategies. A significant majority of the portfolio will be exposed to Real Assets such as high quality real estate, timber, infrastructure assets, industrial and precious metals, energy, livestock and grains.

#### PERFORMANCE & RISK EXPECTATIONS:

The composite portfolio is expected to meet the following objectives over a 10-year time period:

- Provide risk adjusted returns that are less correlated to the public equity markets;
- Reduce portfolio volatility with and provide downside protection;
- Provide a hedge against inflation;
- Generate returns through both capital appreciation and cash flow;

#### SECTION 2.

#### SUB-STRATEGY DESCRIPTIONS

## A. STABLE VALUE REAL ESTATE

GENERAL OBJECTIVES: The composite portfolio is intended to provide the Fund with long-term, net returns between those of public equity and fixed income investments with lower volatility. Additionally, Real Estate assets are expected to diversify the Fund portfolio with low correlation to other Fund investments and provide inflation protection. It is expected that income will be a significant component of the portfolio's total return.

The portfolio generally includes strategies that invest globally in well-located assets, operating and substantially leased, employ relatively low leverage, in traditional and non-traditional strategies. Traditional strategies include office buildings, residential, industrial, lodging, and retail. Non-traditional strategies include agriculture, timber, infrastructure assets, campus housing, medical office, senior living, storage, finance/debt and any other physical asset type with similar risk and return characteristics. The Investment Manager is expected to earn the highest rate of return consistent with the established risk tolerance, guidelines, and performance criteria.

**Performance & Risk Expectations:** Generally, liquidity is limited during the term of the investment (5-12 years). However, through income and distributions, the Trust Company expects significant annual cash flow from the fully mature portfolio. Investments have relatively low historical standard deviation of returns relative to other asset classes. The composite portfolio is expected to meet the following objectives over a 10-year time period:

- Performance should meet or exceed the total return, of an index of comparable institutional quality investment strategies.
- Maximum aggregate portfolio leverage (combined portfolio and property) shall be similar to the average leverage of an index of comparable institutional investment strategies.
- The portfolio will be diversified by vintage year, geography and property type.

#### B. ENHANCED RETURN REAL ESTATE

GENERAL OBJECTIVES: The composite portfolio is intended to enhance overall portfolio returns relative to other major asset classes and provide a diversification benefit. Additionally, portfolio assets are expected to diversify the Fund portfolio with non-correlated investments and provide a degree of inflation protection.

Typically, capital appreciation represents a majority of the total return, while income represents a smaller portion. Higher leverage is generally employed. Strategies will represent a wide range of investments with different types of risks derived from the underlying real estate assets. Risk attributes may include higher property risks such as lease-up, renovation, and development risks. Includes all opportunistic and value add real estate strategies.

The portfolio includes domestic and non-US investments in traditional and non-traditional strategies. Traditional strategies include office buildings, residential, industrial, lodging, and retail. Non-traditional strategies include agriculture, timber, infrastructure assets, campus housing, medical office, senior living, storage, finance/debt and any other physical asset type with similar risk and return characteristics. The Investment Manager is expected to earn the highest rate of return consistent with the established risk tolerance, guidelines, and performance criteria.

**PERFORMANCE & RISK EXPECTATIONS:** The composite portfolio is expected to meet the following objectives over a 10-year time period:

- The portfolios will be managed to exceed the total return of an index market weighted blend of the National Council of Real Estate Investment Fiduciaries Townsend Value Add & Opportunistic Index.
- Maximum aggregate portfolio leverage (combined portfolio and property) shall not exceed 90%.
- The portfolio will be diversified by vintage year, geography and property type.

## C. GLOBAL INFLATION-PROTECTED SECURITIES (GIPS)

**GENERAL OBJECTIVES:** The Inflation-Protected composite portfolio is intended to provide a positive rate of return with inflation protection and to dampen the overall volatility of the Fund.

**PERFORMANCE & RISK EXPECTATIONS:** The performance is expected to meet or exceed established benchmarks and be above median relative to a peer group of institutional quality funds.

- All securities must be sovereign issues.
- Securities may be denominated in the relevant native currency, the US Dollar or the Euro.
- The portfolio will have a beta & correlation of 0.5 or higher relative to the Barclays Capital Global Inflation Linked Bond Index.

#### D. NATURAL RESOURCES

GENERAL OBJECTIVES: The composite Natural Resources portfolio is intended to include investment opportunities within the commodities and natural resource sector that provide a diversified portfolio with low correlation to the equity and fixed income markets and provide inflation protection. The portfolio will include primarily liquid strategies of commodities, energy and materials equity and other assets whose price is influenced by prices of natural resources.

**PERFORMANCE & RISK EXPECTATIONS:** The Natural Resources composite portfolio is expected to meet the following objectives over a market cycle:

- Total returns at least equal to a blend of the Dow Jones UBS Commodity Index (DJ-UBSCI), the MSCI Energy Equity Index and the MSCI Materials Equity Index;
- Minimum beta: 0.5 to DJ-UBSCI.

#### CHAPTER XI. ALL ASSET STRATEGIES

#### SECTION 1.

#### STRATEGY DESCRIPTION

GENERAL OBJECTIVES: All asset strategies include exposures across equity, fixed income and real asset classes. The All Asset portfolio may consist of long-only, hedged and private strategies whose portfolios are diversified across a broad range of asset types.

**PERFORMANCE & RISK EXPECTATIONS:** It is expected that these strategies will provide long term results that are consistent with the return and risk objectives of the total Fund. The following metrics, measured over a full market cycle, will be used when evaluating the each individual strategy and the composite portfolio.

- Beta & Correlation of more than 0.5 to the Fund.
- Comparable performance expectations and volatility to the total Fund.

#### SECTION 2.

#### SUB-STRATEGY DESCRIPTIONS

#### A. RISK PARITY

GENERAL OBJECTIVES: Risk Parity strategies are typically long-only and designed to diversify investment risk exposures uniformly across a range of asset types and hold exposures constant throughout investment cycles. By focusing on diversification of risk exposures rather than nominal exposures to asset classes, the strategy is expected to deliver more consistent returns in each phase of an investment cycle.

#### B. TACTICAL ASSET ALLOCATION

GENERAL OBJECTIVES: Tactical Asset Allocation strategies are funds that invest across a broad range of asset classes, both long-only and long/short. Allocations to different risk exposures and investment strategies are actively managed with a goal of positioning portfolios to achieve performance alpha during all phases of investment cycles.

#### C. MULTI-STRATEGY HEDGE

GENERAL OBJECTIVES: Multi-strategy hedge funds use a diversified combination of hedge fund strategies in a single fund structure to keep overall volatility relatively low and attempt to produce positive returns during all economic environments. The types of strategies included in multi-strat funds include long/short equity, relative value, event driven and tactical trading.

**3-MONTH T-BILL:** The 90 Day U.S. Treasury Bill is auctioned weekly by the U.S. Treasury and is considered a risk-free investment. The performance is represented by the Federal Reserve H.15 report on Constant Maturity Treasury - 3 Month.

BARCLAYS CAPITAL UNIVERSAL BOND INDEX: A broad-based measure of the international fixed-income bond market. The index represents the union of the Global Aggregate Index and the Global High Yield Index.

BARCLAYS CAPITAL WORLD INFLATION LINKED BOND INDEX: Includes bonds that have cash flows linked to an inflation index.

**DOW JONES UBS COMMODITY INDEX:** The DJ-UBSCI is designed to provide diversified exposure to commodities as an asset class, and includes energy, precious metals, livestock and grains.

HFRI FOF - CONSERVATIVE: FOFs classified as "Conservative" seek consistent returns by primarily investing in funds that generally engage in strategies such as Equity Market Neutral, Fixed Income Arbitrage and Convertible Arbitrage with relatively low volatility. Index return is net of manager fees.

**HFRI FOF** – **STRATEGIC**: FOFs classified as "Strategic" seek superior returns by primarily investing in funds that generally engage in opportunistic strategies such as Emerging Markets, Sector specific and Equity Hedge with higher relative volatility. **MSCI ACWI:** The Morgan Stanley Capital International - All Country World Index IMI is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. Index return is net of manager fees.

MSCI ENERGY & MATERIALS EQUITY INDICES: The Morgan Stanley Capital International Energy & Materials Indices are market capitalization indices that are designed to measure the equity market performance of the Energy & Materials global industry classification system sectors.

NCREIF TOWNSEND CORE INDEX: Core funds typically utilize low leverage and invest domestically in stabilized assets. Index return is net of manager fees.

NCREIF TOWNSEND OPPORTUNISTIC INDEX: Opportunistic funds include investments that take on considerable additional risk in order to achieve higher returns. Typical sources of risk are: development, debt, land investing, operating company investing, international exposure and distressed properties. Index return is net of manager fees.

**NCREIF TOWNSEND VALUE ADDED INDEX:** Value Added fund vehicles invest in core returning property types that take on additional risk from one or more of the following sources: leasing; re-development, exposure to non-traditional property types. Index return is net of manager fees.

NCREIF TOWNSEND VALUE ADDED & OPPORTUNISTIC BENCHMARK: A custom blend of the composite indices based on the Net Assets of each index, calculated quarterly. Index return is net of manager fees.

THOMSON REUTERS VENTURE ECONOMICS PRIVATE EQUITY INDEX: A composite of buyout venture capital, and special situation funds. The benchmark will be custom weighted by the vintage year adjusted valuations of the fund. Index return is net of manager fees.